The Accounting Officer
Engcobo Municipality
PO Box 24
Engcobo
5050

19 April 2010

Reference: 18444REG08/09

Dear Sir

Report of the Auditor-General on the financial statements and performance information of Engcobo Municipality for the year ended 30 June 2009.

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act, 2004 (Act No. 25 of 2004) read in conjunction with section 188 of the Constitution of the Republic of South Africa, 1996 and section 121(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).

2. The audit report is issued as a final draft pending our receipt of all other documents that will be included in the annual report that will contain the audited financial statements when received.

3. Once these documents are received we will read them to establish if there are any inconsistencies with the audited financial statements. You will then be requested to amend the other information or the financial statements in respect of any inconsistencies. Once this process has been satisfactorily completed we will issue the final signed audit report.

4. In terms of sections 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.

5. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.

6. Prior to printing or copying the annual report which will include the audit report you are required to do the following:

   - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South African for verification of the audit related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
   - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when

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preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.

7. Please notify the undersigned Operations Leader well in advance of the date on which the annual report containing the audit report, will be tabled.

8. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed

....

Senior Manager: EL010

Enquiries:	Natasha Heuer
Telephone:	(043) 709 7200
Fax:	(043) 709 7300

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE ENGCOBO MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Engcobo Municipality which comprise the statement of financial position as at 30 June 2009, and the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Statements of Generally Recognised Accounting Practice (Statements of GRAP) and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal controls as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Accumulated surplus

4. I was not able to confirm whether amounts disclosed for 2008 and 2009 that related to revenue, employee cost, expenditure, accumulated surplus, cash and bank, accounts payable, account receivable, property, plant and equipment, disclosure and other matters, investments, consumer deposits, borrowings, provisions, funds and reserves, unspent conditional grants and inventory were adjusted to correct and attend to misstatements and limitations that caused me, not to express an opinion on the financial statements for the year ended 30 June 2008.

5. Previously disclosed funds amounting to R120,9 million were transferred to accumulated surplus according to note 25.1 to the financial statements. Transferred funds amounting to R1,3 million could however not be agreed to the relevant accounting entries within the municipality's accounting system.
6. The balance of accumulated surplus per the general ledger exceeded the balance of accumulated surplus per the trial balance by R651 747. I was also unable to gather sufficient appropriate evidence to confirm the correct treatment and suitability of journal entries amounting to R645 107. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures the impact of these matters could not be assessed.

Change in accounting policy

7. Note 25 to the annual financial statements, change in accounting policy, did not include disclosure of the intermediary provisions and adjustments relating to periods before those presented in the annual financial statements for the year ending 30 June 2009 as required by the Standard of Generally Recognised Accounting Practice, GRAP 3, *Accounting policies, changes in accounting and errors.*
8. An amount of R1,1 million was disclosed as "Non-existent assets previously not recorded debited to Accumulated Surplus/(Deficit)" under note 25 to the financial statements. This amount represents a correction of a prior year error and not a change in accounting policy as disclosed in note 25.
9. Documentation validating other adjustments amounting to R606 504 included under note 25.4 could not be obtained. Municipal records did not permit the application of alternative procedures to confirm this movement in the accumulated surplus.

Prior period errors

10. Prior period errors amounting to R5,6 million and R505 027 relating to grants and stale cheques, respectively, were not disclosed in the financial statements.
11. The movement in the accumulated surplus account in the general ledger amounting to R84,3 million did not agree to the movement disclosed in the statement of changes in net assets and note 25 to the annual financial statements amounting to R94,9 million.

Irregular expenditure

12. Bid evaluation and adjudication reports and/or minutes that related to tenders with a total value of R211,6 million could not be provided, this prohibited the evaluation of compliance to the Municipal Supply Chain Management Policy and the identification of irregular expenditure. Similarly compliance to the Municipal Supply Chain Management Policy regarding advertising could not be determined for a tender amounting to R462 000. In the absence of such documentation and the lack of alternative audit procedures, it was not possible to determine whether irregular expenditure, as disclosed in the annual financial statements, is complete.
13. Irregular expenditure amounting to R15,7 million identified and reported in paragraph 36 of my report on the financial statements for the year ended 30 June 2008 was not disclosed in the annual financial statements.

Operating expenditure

14. The total corresponding expenditure, excluding employee related costs and councillors remuneration, disclosed at R30,4 million on the face of the statement of financial performance and notes 20 and 21 to the annual financial statements, does not agree to the total expenditure of this nature that amounted to R23,5 million in the prior year audited annual financial statements.
15. Depreciation for the year ending 30 June 2009, inappropriately includes depreciation of water and sanitation assets that were transferred to the district municipality on 1 July 2008. A loss on the sale of these assets, amounting to R9,3 million, was disclosed on the face of the statement of financial performance and note 22 to the financial statements. The entity's records indicate that had management applied depreciation correctly, depreciation would have increased by R3,1 million and the loss on sale of assets would similarly have decreased by the same amount.
16. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to determine whether journal entries reducing expenditure by R2,1 million were correct and have sufficient foundation and the necessary approvals. In addition, the completeness of journals affecting expenditure could not be determined.
17. Due to the limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to substantiate expenditure amounting to R18,9 million. The limitations experienced furthermore prohibited the identification of fruitless and wasteful expenditure.

Employee costs

18. Employee related costs were disclosed at R15,3 million on the face of the statement of financial performance and in note 18 to the annual financial statements. Remuneration of councillors was disclosed at R5,9 million on the face of the statement of financial performance and in note 19 to the annual financial statements. These amounts could not be reconciled to the amounts reflected in the payroll system.
19. In the absence of documentation in support of journals and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to substantiate transactions amounting to R1,7 million processed to employee related costs as disclosed in note 18 to the annual financial statements.
20. Suspense accounts relating to employee costs totaling R606 638 were not cleared at year end. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not determine the suitability of balances included in suspense accounts that increased receivables by R2,3 million, decreased employee costs by R606 638 and increased cash and cash equivalents by R776 659.

Accounts payable

21. Documentation in support of a R4 million account balance could not be obtained. The existence of the municipality's obligation could not be confirmed from alternative information sources which included loan confirmations received from third parties.

22. Accruals amounting R2,9 million were not included in the annual financial statements for the year ended 30 June 2009. The accruals listing for the year ended 30 June 2009 furthermore exceeded the general ledger account balance for accruals by R20 million. Had these creditors been recognised, accounts payable and expenditure would have increased by R22,9 million. I could not confirm the completeness of accruals as disclosed in the annual financial statements.

23. The corresponding total for trade and other payables from exchange transactions is disclosed at R11,4 million on the face of the statement of financial position and in note 7 to the annual financial statements. Trade and other payables in the prior year audited annual financial statements amounted to R9,4 million. Explanations and reconciliations of the difference of R2 million could not be obtained.

24. The prior year audited annual financial statements incorporated a salary control account with a credit closing balance of R674 250. This balance could not be reconciled to the debit opening balance of R260 227 reflected in the general ledger as at 1 July 2008. The municipality could not provide explanations or reconciliations of the difference of R934 477.

25. Unrecorded trade and other payables from exchange transactions, amounting to R10 million, were identified in municipal records. Due to limitations placed on the scope of my work, I could not confirm the completeness of trade and other payables from exchange transactions disclosed. In addition, it was not possible to determine whether trade and other payables are stated at the correct amount.

26. Trade and other payables were not disclosed and measured at fair value taking into account imputed interest as required by International Financial Reporting Standards, IFRS 7, *Financial Instruments: Disclosure* and International Accounting Standards, IAS 39, *Financial Instruments: Recognition and Measurement* respectively. My inability to quantify the misstatement in trade and other payables and consequently expenditure also impacted on the quantification of any fair value adjustment that may be required.

27. From municipal records it was calculated that leave accruals amounting to R879 373 were not included in the annual financial statements for the year ended 30 June 2009. The completeness and total of the calculated leave accrual could however not be confirmed due to the limitations placed on the scope of my work. As a result, the impact on employee costs could not be assessed.

Property, plant and equipment

28. Accounting policy 1.2 to the annual financial statements refers to relief relating to the measurement of property, plant and equipment in terms of Directive 4 issued by the Accounting Standards Board. The relief detailed is in contradiction to the transitional provisions included in Directive 4 which requires the municipality to identify, correctly classify, recognise and measure all assets by either applying the Standards of GRAP or measuring assets at provisional amounts.

29. The carrying value of property, plant and equipment is disclosed in the statement of financial position at R76.5 million. This amount does not agree to the fixed asset register which reflects a total of R77.1 million. In the absence of reconciliations for the difference, I was unable to identify assets not included in the fixed asset register and consequently I could not confirm or verify by alternate means the existence, completeness and correct classification of property, plant and equipment.

30. Depreciation disclosed at R7,1 million in the statement of financial performance and note 20 to the annual financial statements does not agree to depreciation reflected in the fixed asset register that amounted to R7,7 million. In addition, the municipality did not consider the impairment of property, plant and equipment, or any circumstances which would lead to a change in the residual value or useful life of property, plant and equipment. In the absence of such records and reconciliations, I was unable confirm or verify by alternative means that accounting records supported the values disclosed as property, plant and equipment in the financial statements.

31. The general ledger and note 6.1 to the financial statements reflect a disposal of property, plant and equipment of R7,2 million. Note 22 to the financial statements reflect a loss on disposal of property, plant and equipment of R9,3 million. Property, plant and equipment amounting to R1.1 million was transferred to the district municipality during the financial year. In the absence of supplementary information, it was not possible to reconcile these differences; I was subsequently unable to confirm that all disposed items of property, plant and equipment were correctly removed from the records of the municipality.

32. Property, plant and equipment amounting to R5,5 million could not be physically verified due to inadequate descriptions in the fixed asset register. Adequate documentation in support of additions to property, plant and equipment amounting to R8,3 million could furthermore not be obtained. Due to limitations placed on the scope of my work, I could not gather sufficient appropriate evidence to confirm that all property, plant and equipment existed and was accurately accounted for.

33. The opening balance of property, plant and equipment was restated from a credit balance of R13 547 to a debit balance of R83,6 million as disclosed on the statement of financial position. The nature, amount and reason for the reclassification of opening balances was not disclosed in the financial statements. Furthermore, supporting documentation relating to the adjustments was not provided for audit purposes.

Provisions

34. The annual financial statements do not include a provision for the rehabilitation of the illegal Engcobo landfill site.

35. The provision for accounting fees that amounted to R562 590 in the prior year audited financial statements was transferred to the accumulated surplus, as it was a prior period error. Detailed information supporting this transfer as required by Standard of Generally Recognised Accounting Practice, GRAP 3, *Accounting policies, changes in accounting and errors* and GRAP 19, *Provisions, contingent liabilities and contingent assets* was not disclosed in the annual financial statements.

Receivables

36. Interest was not charged on all overdue accounts as required by section 97(1)(e) of the Local Government Municipal System Act, Act No.32 of 2000. The entity's records indicate that accounts receivable and net profits would have increased by R3,8 million had management charged interest as required.

37. Receivables with general ledger opening balances amounting to R4,2 million could not be agreed or reconciled to the balance of R1,7 million included in the prior year audited annual financial statements. Trade and other receivables from exchange transactions, before provision for bad debts, disclosed at R1,9 million in note 2 to the annual financial statements did not agree to the debtor's age analysis that reflected a total of R3,4 million. Municipal records did not permit alternative procedures to resolve the unexplained and unreconciled differences.

38. In the absence of journals and documentation supporting journals and with municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to substantiate receivables amounting to R1,8 million.

39. Receivables that amounted to R 12,4 million were written off to the accumulated surplus in the process of converting the financial statements from the entity specific basis of accounting to the Statements of GRAP. The write-off of receivable accounts which effectively represents bad debts written off was not disclosed as such in the notes to the annual financial statements for the year ended 30 June 2009.

40. The municipality did not calculate the financing portion of debtors that should have been transferred to interest expenditure in line with International Accounting Standard, IAS 39, *Financial Instruments: Recognition and Measurement* which requires loans and receivables to be measured at amortised cost using the effective interest method. My inability to quantify the misstatement in trade and other receivables and consequently revenue also impacted on the quantification of any fair value adjustment that may be required.

41. The assumptions made to estimate the provision for bad debts could not be obtained and were not disclosed in the annual financial statements as required by International Financial Reporting Standards, IFRS 7, *Financial Instruments: Disclosure.* As reflected in paragraph 37 to 41 municipal records did not facilitate an estimation of receivables that may not be recoverable.

Other receivables from non-exchange transactions

42. Documentation supporting a schedule that summarised the movement in other debtors, disclosed at R723,297 in note 3 to the annual financial statements, could not be obtained. In the absence of supporting documentation, third party confirmations and the municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to substantiate the balance of other receivables from non-exchange transactions.

Unspent conditional grants

43. The closing balance of unspent conditional grants that amounted to R4 million in the audited financial statements of the prior year could not be agreed to the opening balances of the general ledger accounts as at 1 July 2009 that disclosed zero balances.

44. Government grants and subsidies are disclosed at R42,2 million with corresponding figures disclosed at R31,8 million on the face of the statement of financial performance and note 16 to the annual financial statements. This revenue recognised exceeds the total of grant liabilities transferred to revenue disclosed for the 2009 and 2008 year in note 16.1 to 16.3. The allocation and recognition of grant receipts amounting to R1,8 million could furthermore not be confirmed. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not determine the impact on the unspent grants and grant revenue disclosed.

45. Schedules that supported grant expenditure and grant revenue could not be obtained. With municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to confirm the expenditure incurred, the balance of the remaining unspent grants and the correctness of revenue amounting to R11,6 disclosed as MIG grants and other government grants and subsidies in note 16 to the annual financial statements.

46. Amounts previously disclosed as funds were transferred to unspent conditional grants according to note 25.1 to the financial statements. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to confirm that transfers amounting to R1,6 million were appropriate and that all unspent conditional grants, previously recognised as funds, were actually transferred.

Cash and cash equivalents

47. Cash and cash equivalent balances per the trial balance exceeded cash and cash equivalent balances per the general ledger by R9,5 million. The difference noted was neither reconciled nor explained.

48. Investments disclosed on the face of the statement of financial performance and note 8 to the annual financial statements include amounts totaling R8,6 million that were readily convertible into known amounts of cash. These amounts were not disclosed as cash and cash equivalents as required by the Standard of Generally Recognised Accounting Practice, GRAP 2, *Cash flow statements*.

49. It could not be confirmed that receipts amounting to R835 524 were recognised in the appropriate general ledger accounts within the municipal accounting system. Accordingly, I was not able to determine whether any adjustments might have been necessary to the amounts shown in the financial statements for revenue and cash and cash equivalents.

Capital commitments

50. Capital commitments disclosed at R210,9 million in note 28 to the annual financial statements did not agree to the recalculated capital commitments and the schedule of commitments by R4,8 million and R1,0 million, respectively. Capital commitments furthermore did not include costs amounting to R1,5 million that were approved prior to 30 June 2009.

51. Contracts in support of capital commitments could not be obtained. In the absence of alternative audit procedures, I could not gather sufficient appropriate evidence to substantiate the commitments that amounted to R1,7 million Similarly I could not confirm that all capital commitments were disclosed in note 28 to the annual financial statements.

Going concern

52. The municipality is largely dependant on financial support received from government. In the absence of grants and subsidies the municipality would not have generated sufficient internal revenue during the 2008/2009 year to fund their total expenditure. This material uncertainty may cast significant doubt on the municipality's ability to continue as a going concern and was not disclosed in the annual financial statements.

Contingent liabilities

53. Ongoing litigation, not finalised at year end was identified that was not disclosed as contingent liabilities, as required by the Standard of Generally Recognised Accounting Practice, GRAP 19, *Provisions, Contingent liabilities and Contingent assets*. I could not gather sufficient appropriate evidence to confirm that all contingent liabilities were disclosed due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures.

54. The municipality has not disclosed a contingent liability for the closure and rehabilitation of the illegal landfill site operated during the financial year.

Investments

55. Investments were disclosed at R9,2 million on the face of the statement of financial position and note 4 to the annual financial statements. Interest earned on external investments was disclosed at R497 586 on the face of the statement of financial performance and note 15 to the annual financial statements. Investments would have amounted to R8,6 million and interest earned would have amounted to R1 million had investments been disclosed at amounts confirmed by financial institutions.

56. Investments with general ledger opening balances amounting to R4,7 million in the current year could not be reconciled to the total of R3,6 million disclosed for these investments in the prior year audited annual financial statements.

57. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to confirm the applicability of journal entries processed in investment accounts that amounted to R2,2 million.

Investment Property

58. Investment property included in the fixed asset register amounting to R6,5 million was not separately disclosed as investment property in the financial statements as required by Generally Recognised Accounting Practice, GRAP 16, *Investment property*.

Revenue

59. Revenue per the trial balance for the year ended 30 June 2009 exceeded revenue per the general ledger by R9,8 million.

60. Property rates is disclosed at R1,5 million on the face of the statement of financial performance and in note 12 to the annual financial statements. These rates were levied based on a general valuation performed in 1999. No evidence could be obtained of a supplementary or interim valuation being performed. Based on a general valuation that was implemented on 1 July 2009, revenue from property rates, would have amounted to R2,9 million had the general valuation been implemented on 1 July 2008 or had supplementary and interim valuations been performed.

61. Rental of facilities and equipment, fines, licenses and permits and other income totaling R4,4 million is disclosed in the statement of financial performance. The municipality did not maintain direct income and other income registers. Originating source documents and supporting documentation for transactions processed amounting to R4,7 million could furthermore not obtained. In the absence of the information noted above it could not be confirmed that all revenue from the mentioned revenue sources were accurately accounted for.

62. Current year receipts for the MIG grant amounting to R13,5 million as disclosed in note 16.2 to the annual financial statements did not agree to the distributed R11,3 million per the Division of Revenue Act or to the cash receipts per the bank statements that amounted to R12,7 million. Similarly grants transferred to revenue amounting to R8,9 million also disclosed in note 16.2 did not agree to capital project reports that reflected expenditure of R9,4 million. Due to the differences noted and the absence of alternative procedures, I was unable to confirm or verify adjustments necessary to the current portion of unspent conditional grants and receipts, property plant and equipment and government grants and subsidies.

VAT receivable

63. VAT was inappropriately claimed on employee tax and skills development levy expenditure. Had these invalid claims been appropriately accounted for, the VAT receivable would have decreased by R1,1 million.

64. Documentation supporting input VAT and output VAT totaling R3 526 205 could not be obtained to support transactions processed to VAT related accounts. Journals that increased the VAT receivable by R949,999 could furthermore not be validated to supporting information.

65. VAT due to the municipality according to a confirmation received from the South African Revenue Services indicated amounts totaling R4,2 million. These amounts due could not be agreed to the R3,2 million disclosed on the face of the statement of financial position

66. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I was unable to quantify the effect of the limitation of scope experienced on the VAT receivable balance, expenditure and revenue.

Financial instruments

67. Financial assets, financial liabilities as well as financial risk management is not disclosed in the annual financial statements as required by IFRS 7 (AC 144) *Financial Instruments: Disclosures*

Events after the reporting date

68. The municipal manager was dismissed subsequent to the reporting date following a disciplinary hearing. The details, of this material non-adjusting event after the reporting date, was not disclosed in the annual financial statements, as required by the Standard of Generally Recognised Accounting Practice, GRAP 14, *Events after the reporting date.*

Post retirement benefits

69. The nature and amounts recognised as expenses related to the defined contribution plans was not disclosed in the annual financial statements as required by International Accounting Standard 19: *Employee Benefits.*

Consumer deposits

70. Consumer deposits are disclosed at R74 238 on the statement of financial position and in note 8 to the annual financial statements. In terms of a service level agreement this balance should have been transferred to the district municipality, decreasing consumer deposits and other debtors included under other accounts receivable.

71. Inspection of the consumer deposit register revealed that no deposits were paid by the residential consumers for services rendered by the municipality. The amount of the understatement could not be determined.

Unauthorised expenditure

72. Unauthorised expenditure amounting to R985 115 identified in the prior year and reported in paragraph 32 of my prior year audit report and prior year expenditure amounting to R8 million expended for purposes other than stipulated as reported in paragraph 33 of my prior year audit report was not disclosed in the annual financial statements. Evidence could not be obtained that unauthorised expenditure was treated in accordance with section 32 of the Municipal Finance Management Act, Act 56 of 2003.

73. Documentation supporting the unauthorised expenditure amounting to R8,4 million in note 26.1 to the financial statements could not be obtained. Note 26.1 furthermore does not disclose details on whether unauthorised expenditure is recoverable and details of material losses recovered or written off during the year as required by section 125(2)(d) of the Municipal Finance Management Act, Act 56 of 2003 and the Standard of Generally Recognised Accounting Practice, GRAP 1, *Presentation of financial statements.*

74. Actual revenue and expenditure of the municipality could not be compared to the adjusted budgeted due to differences in the basis of preparation and the different categorization of items contained in these documents. The budget was not arithmetically correct. Unexplained and unreconciled differences amounting to R2,1 million that related to expenditure and capital expenditure was identified. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to quantify unauthorised expenditure that may have been incurred.

Current portion of borrowings

75. The International Financial Reporting Standard, IFRS 7, *Financial Instruments: Disclosure*, requires separate disclosure of interest, security, details of breaches and terms that related to long term borrowings. The required information was not disclosed in note 11 to the annual financial statements that reflected the current portion of borrowings at R1,3 million.

Disclaimer of opinion

76. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matters on which I do not express a disclaimer of opinion:

Significant uncertainties

77. With reference to note 30 to the financial statements, the municipality is the defendant in three lawsuits with claims amounting to R24,7 million. The municipality is opposing the claims in all three cases. The ultimate outcome of these matters cannot presently be determined, and no provision for any liability that may result has been made in the financial statements

Fruitless and wasteful expenditure

78. Fruitless and wasteful expenditure that relates to the late payment of employees tax was incurred. The amount of R16 643 was not treated as prescribed by the Municipal Finance Management Act, was not classified as such in the municipal accounting records and details were not disclosed in the annual financial statements as required by section 125 of the MFMA.

Irregular expenditure

79. The benefit of a rent free residence made available to an official was not within the framework of the Public Office-Bearers Act, 1998 (Act No. 20 of 1998). Based on municipal records the irregular expenditure not disclosed in this regard amounted to R20,846.
80. Expenditure amounting to R209 134 was incurred without obtaining the pre-requisite number of quotation, as required by the municipality's Supply Chain Management Policy. The identified irregular expenditure was not disclosed in the annual financial statements as required by section 125(2) of the MFMA.

Other matters

81. I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Material inconsistencies in other information included in the annual report

82. The annual report omitted a number of items required in terms of Section 121 of the MFMA. It was noted that the annual report presented for audit purposes was not fully populated and inappropriately includes the executive summary from the draft management report that relates to the audit of the financial statements for the year ending 30 June 2009.

Unaudited supplementary schedules

83. The supplementary information set out in pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

84. Council minutes and resolutions that approved the disposal of assets as required by section 14(2) of the MFMA were not obtained.

85. Section 17(3)(b) of the MFMA was not complied with as measurable performance objectives for revenue from each source and for each vote in the budget, taking into account the municipality's integrated development plan, was not compiled and presented with the annual budget.

86. The municipality did not maintain an effective system of expenditure control as required by section 65 (2) of the MFMA. As reported in my prior year report, payments to creditors were not made within 30 days of receipt of the invoice as required by section 65(2)(e) of the MFMA.

87. Electronic and signed returns on conditional grant spending for the period ending 30 June 2009 were not submitted to National Treasury as required by section 74(1) of the MFMA.

88. Section 125(2)(e) of the MFMA was not complied with as the notes to the annual financial statements of a municipality did not disclose particulars of non-compliance with the Act.

Environmental Conservation Act, 1989 (Act No 73 of 1989)

89. A permit was not issued for the municipality's landfill sites located in Engcobo, as required by the Environmental Conservation Act.

Governance framework

90. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

91. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4-6	Accumulated Surplus		1	4		
12-15	Irregular expenditure	2		6		
16-19	Expenditure	1				
20-22	Employee cost			5		
23-29	Trade and other payables		2	4		
30-35	Property, plant and equipment				1	
36-37	Provisions			5		
38-43	Trade and other receivables from exchange transactions	2		4		
44	Other receivables from non-exchange transactions	5				
45-48	Current portion of unspent conditional grants and receipts			3		
49-51	Cash and Cash Equivalents					1
54	Going concern				1	
55	Contingent liabilities			6		
56-58	Investments			4		1
59	Investment property			4		
60-63	Revenue			4		
64-67	VAT receivable		1			
69	Events after reporting date			6		
76	Fruitless and wasteful	5				

	expenditure					
7 10 52 68, 70 71 73 77	Disclosure and other matters	2				

92. The control environment was mostly affected by the inadequacy of control activities. The effectiveness and functioning of internal controls were adversely affected by the lack of approved written policies and procedures and the failure to implement control activities that will address the risks, written policies and procedures that were not in place and failure to implement control activities that will address risks.

93. Insufficient staff resources, limited management oversight, a lack of monitoring processes and inadequate supporting documentation for financial transactions contributed to an environment susceptible to undetected fraud and error.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4

Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

94. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		✔
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		✔
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	✔	
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines [section 126 of the MFMA].		✔
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	✔	
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	The Municipality had an audit committee in operation throughout the financial year.	✔	

No.	Matter	Y	N
	The audit committee operates in accordance with approved, written terms of reference.		✔
	The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		✔
7.	Internal audit		
	The Municipality had an internal audit function in operation throughout the financial year.	✔	
	The internal audit function operates in terms of an approved internal audit plan.	✔	
	The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✔
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		✔
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		✔
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		✔
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 95(c)(i) of the MFMA.		✔
12.	Delegations of responsibility are in place, as set out in section 106 of the MFMA.		✔
Follow-up audit findings			
13.	The prior year audit findings have been substantially addressed.		✔
14.	SCOPA/Oversight resolutions have been substantially implemented	N/A	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✔
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		✔
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Local Municipality against its mandate, predetermined objectives, outputs, indicators and targets in terms of section 87 of the MFMA.		✔
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		✔

95. Management's attention is specifically drawn to the following key governance responsibilities which, according to the above table, have not been effectively addressed.

96. The accounting policies disclosed in the annual financial statements were amended to refer to the application of Directive 4 issued by the Accounting Standard Board.

97. The organisational structure, policies and systems at Engcobo Municipality did not support proper recording and monitoring of accounting transactions. This weakness also affected the availability of a proper audit trail and the ability of the financial section to provide documentation in a timely manner.

98. The financial reporting section lacked adequate skills and competencies to convert the financial statements from the previous basis of accounting to the current basis of accounting. The conversion of the financial statements from IMFO to the Statements of GRAP combined with inadequate planning resulted in the financial statements not being submitted within the timeframes set by the MFMA.

99. Evidence that council approved the written terms of reference of the audit committee could not be obtained. Evidence could not be obtained to demonstrate adequate interaction with the council, internal audit or external audit. No Performance Audit Committee was established. The audit committee was not mandated to, and did not review performance information.

100. Audit manuals and programmes to ensure that internal audits were adequately planned, supervised, reviewed and documented were not in place. The absence of internal audit training, development programmes, follow-up audits, alternative procedures to ensure implementation of internal audit recommendations as well as policies and procedures to ensure compliance with the IIA standards were also noted.

101. Deficiencies in the design and implementation of internal controls were identified. Regular risk assessments were not performed while a fraud prevention plan was not implemented at the municipality. The fact that delegations of responsibility were not implemented and prior year audit findings were not addressed represent symptoms of an ineffective organisational structure and inadequate resources.

102. An investigation was conducted into the procurement processes followed by the municipality. This investigation specifically focused on contracts that related to construction and renovations that were undertaken for the mayoral and municipal manager's residences as well as certain overtime expenditure incurred. The findings of the investigation lead to the suspension of the municipal manager. The investigation has not yet been concluded and currently no criminal procedures have been instituted.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for the performance information

103. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

104. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and read in conjunction with section 45 of the MSA.

105. In terms of the foregoing, my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

106. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

No reporting of performance information

107. The entity has not reported performance against predetermined objectives, as required by Section 121(3)(c) of the MFMA.

Content of integrated development plan

108. The IDP of Engcobo Municipality does not identify the institutional framework, which must include an organogram required for the implementation of the IDP and addressing the municipality's transformation needs, as required by section 26(a) of MSA and regulation 2(a) of Municipal Planning and Performance Management Regulations, 2001.

Existence and functioning of a performance audit committee

109. The Engcobo Municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

110. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

111. The internal audit processes and procedures did not include assessments of the extent to which the Engcobo Municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators.

112. The internal auditors of the Engcobo Municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the performance audit committee.

Lack of adoption or implementation of a performance management system

113. The Engcobo Municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

No mid-year budget and performance assessments

114. The accounting officer of the Engcobo Municipality did not by the 25th of January 2009 assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

Usefulness and reliability of reported performance information

115. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its integrated development plan:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan?
- Relevance: Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?
- Reliability: Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

116. The following audit findings relate to the above criteria:

Inconsistency reported performance information

117. The municipality did not prepare an annual performance information report as required by section 46 of the Municipal Systems Act, No 32 of 2000.

Reported performance information not relevant

118. An assessment could not be performed on the reliability of the reported performance information, as set out on pages xx to xx of the annual report, since the information was not received in time for audit purposes.

APPRECIATION

119. The assistance rendered by the staff of the Engcobo Municipality during the audit is sincerely appreciated.

Auditor-General

East London

19 April 2010

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence